EasCorp
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February 10, 2010

Ms. Mary F. Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Dear Ms. Rupp:

RE: Proposed Changes to 12 CFR Part 704

On behalf of the Board and management of EasCorp, thank you for the opportunity to comment on NCUA's Proposed Corporate Credit Union Regulation.

Before we address the Proposed Regulation, we would like to provide some background about EasCorp and its business activities. Like most corporate credit unions, EasCorp was organized in the late 1970s to provide a convenient and efficient source of short-term investments and credit for its member credit unions. During the 1980s, our business was transformed by two things. The first was the dynamic expansion of payment systems products (e.g., share drafts, credit cards) across the credit union industry. The second was the passage of the Monetary Control Act, which enabled credit unions, including EasCorp, to have access to the Federal Reserve Bank System.

Since then EasCorp has focused on providing correspondent services (e.g., funds transfers, daily financial settlements, currency, etc.) along with traditional short-term investments and credit to its member credit unions. Operating with narrow margins, we built reserves and undivided earnings (RUDE) continuously throughout our history. We placed limited reliance on member-contributed capital, capping our traditional membership capital shares so that no member had more than $500,000 at risk. We avoided applying for expanded investment authorities. We did not aggressively compete for credit union investment dollars through misguided growth strategies. Instead, we managed our balance sheet within a range of $1 billion to $2 billion during the past ten years. We viewed member-contributed capital as "on loan" to us and our goal has always been, and remains, to return it to them as soon as it could be adequately replaced by RUDE.

By focusing on select activities and doing them well, EasCorp has enabled its members to become independent of their direct competitors in the banking industry, while still benefiting from access to the Federal Reserve Bank and the nation's payment systems through a company they own and control. In our opinion, preserving this value proposition for credit unions is the most critical component to this rulemaking process and the overriding rationale for our comments below.

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Unfortunately, EasCorp had an Achilles heel by virtue of the fact that it belonged to and relied on U.S. Central Federal Credit Union for certain parts of its balance sheet management activities. As a condition of membership in U.S. Central Federal Credit Union, EasCorp was required to fund member-contributed capital accounts throughout its thirty-one year relationship. Because of U.S. Central's recent investment losses, most of EasCorp's U.S. Central capital accounts have been depleted. Apart from this effect, EasCorp would be very strong today.

The U.S. Central situation is instructive on many levels. We watched with concern as U.S. Central aggressively grew its balance sheet from mid-2005 until mid-2007, the period immediately preceding its financial crisis. We questioned management's growth strategy and investment portfolio on numerous occasions, but were given limited information about the portfolio in order to make an independent judgment about its quality and strength. As business conditions began to deteriorate in late 2007, U.S. Central was granted several waivers by NCUA that provided exemptions from certain regulations and the flexibility to operate without the customary level of oversight. Members were not provided full disclosure as to the extent of these waivers and, as a result, EasCorp was unable to include the effects of these devices in our due diligence and investment decisions. A cloak of secrecy made it impossible to discern the regulatory standards to which U.S. Central was being held. When we began our withdrawal process in 2008, we discovered that U.S. Central secretly had changed its membership capital rules too, preventing us from obtaining our money.

EasCorp believes the problems that beset U.S. Central and certain other corporate credit unions should never be allowed to happen again. We believe in the value of good corporate credit union regulations. We are mindful of management's responsibilities for establishing prudent policies and practices. However, we also believe that supervision is a critical "third leg of the stool," and we respectfully ask NCUA to consider how its supervisory controls may be improved for our mutual benefit in the future.

The Proposed Corporate Credit Union Regulation purports to bring higher safety and soundness standards to corporate credit union activities. Although this outcome is desirable, it must be balanced against the interest natural-person credit unions have in obtaining value from their business partners, including corporate credit unions. In other words, if corporate credit unions are unable to produce value because of an unnecessarily restrictive regulation, members will not remain members for long—and the matter of safety and soundness will be moot. In this regard, we urge you to consider the modeling we have done, the conclusions we have drawn, and the recommendations we would like to make regarding the following sections of the proposal.

<u>§704.8 Asset and Liability Management</u>

The Proposed Regulation would codify two additional tests related to NEV modeling for asset liability management purposes. The first test would require us to measure the effects of widening credit spreads in the marketplace and combine them with the second test, which would require us to measure the effects of prepayments speeds slowing by 50 percent. Moreover, the proposed new tests would have the effect of limiting the average life mismatch of our assets and liabilities to 90 days, constricting EasCorp's ability to manage to an adequate spread.

As a general rule, NEV is a useful tool for measuring the potential effects of interest rate fluctuations, and EasCorp uses this tool presently to manage volatility within the limits of the current regulation. We are mindful that excessive volatility can have real implications for future interest income and earnings, and never actually exceeded our regulatory limits during the recent market distress.

However, the economic relationship between volatility and earnings does not necessarily hold true when modeling the effects of widening credit spreads on securities, especially securities that are used as part of a "buy and hold" strategy. What's more, because credit spreads are a function of liquidity in the marketplace, and each sector of the marketplace is affected differently by liquidity conditions, it is an overreach, even for scoping purposes, to apply uniform and extreme stress test conditions across each sector of a portfolio. Indeed Section 704.6(d) of the Proposed Regulations, *Sector Concentration Limits,* acknowledges this important distinction.

In the preamble to the Proposed Regulation, NCUA presents an "example" portfolio and stipulates that the portfolio could earn 34 basis points of assets and meet the earning retention requirements. The example is poorly drawn inasmuch as it contains unrealistic assumptions about the availability of certain securities and the use of interest rate "swaps," as well as an excessive concentration of asset-backed securities with undesirable risk characteristics. The effect of NCUA's proposed tests related to NEV would be to restrict, perhaps eliminate, EasCorp's use of floating-rate securities, including government agency securities, unless we apply for and are approved to use derivatives, a tool that EasCorp's Board of Directors has been disinclined to do. The ability to take positions in floating-rate securities is essential to sound asset-liability management because, in most cases, they contain negligible interest-rate risk.

By contrast with your example, EasCorp applied the new tests and limitations in the Proposed Regulation to its November 30, 2009 balance sheet, allowing for the imminent write-off of its remaining membership shares in U.S. Central. With an investment portfolio 80 percent of which is equally split between cash and government agency securities, and a closely matched liability portfolio, EasCorp was unable to conform to either of the new NEV standards in the proposal. In accordance with the proposal, if this situation persists for 30 days or more, Prompt Corrective Action (PCA) standards would apply, including an immediate lowering of our status to "undercapitalized." If this process continues, the next step under this and numerous other references to PCA throughout the Proposed Regulation, is an administrative process that would enable NCUA to intervene in all aspects of managing EasCorp's business, with no discernible rights to appeal the process or consequent sanctions.

If the new tests are adopted as proposed, and EasCorp is required to conform, we would sacrifice valuable earnings and our members would be required to pay a variety of account, credit, service, and/or administrative fees or fee increases in order to restore earnings to the necessary requirements.

Our careful analysis of the causes of portfolio underperformance in the recent past leads us to recommend that these standards be changed. This recommendation is consistent with NCUA's stated goal that the sins of the past not be repeated in the future. We recommend either raising the limits for compliance with NEV volatility measures as they apply to the widening credit spreads test or providing for varying levels of stress across different sectors of the investment portfolio so that only sectors most likely to be affected severely by widening credit spreads (e.g., non-Agency mortgage-backed securities) would be stressed in the extreme. With respect to the test for slowing prepayment speeds by 50 percent, we suggest that you limit this application to mortgage-backed securities only. As a practical matter, slowing prepayment speeds are rarely a consideration with other types of collateral. We also urge NCUA to delay the implementation of the new ALM modeling standards so that they become effective no sooner than twelve months following the publication of the regulation.

<u>§704.3 Corporate Credit Union Capital</u>

The Proposed Regulation would require EasCorp to have a Retained Earnings Ratio of 45 basis points of assets no later than three years following the effective date. This equates to 15 basis points per year for each of the first three years. We believe that this target is both inconsistent with the stated goals for lowering risk and unrealistically ambitious for a variety of other reasons. The first and foremost reason is the ALM standards set out in the proposed regulation and discussed above. These standards will make it extremely difficult to earn spread income in a traditional way.

Economic conditions, specifically the general level of interest rates, are very unfavorable at the present time, and are forecast to remain this way for the foreseeable future. EasCorp is disinclined to seek additional yield for this purpose by compromising its credit standards in the interest of obtaining higher yields, and we hope NCUA would affirm this strategy in its development of a model investment portfolio and a range of realistic earnings targets. As written, the Proposed Regulation poses a dilemma for EasCorp inasmuch as we can target the risk or return, but not both.

Finally, we would like to point out that traditionally EasCorp's least expensive source of funds has been retained earnings (zero cost). By December 31, 2009, our retained earnings, and the advantages it provided to us, were fully-depleted.

We understand that NCUA has established new capital standards and terms for qualifying member-contributed capital as so-called Tier I capital, and we take no exception to the capital section of the Proposed Rule generally. Indeed EasCorp undertook a successful recapitalization effort in 2009, and we are awaiting the development of final regulations in order to determine what additional support we will require from our members. We are mindful that member-contributed capital will be a referendum of sorts on the value attributed to EasCorp and its services by member credit unions. That said, if EasCorp is able to reach or exceed regulatory capital standards with the help of its members, it is less certain why NCUA feels compelled to require a specific level of accumulated retained earnings as a matter of regulation. Although we agree with NCUA that a mix of member-contributed capital and retained earnings is desirable, we are concerned about the timing of and the target for the Retained Earnings Ratio requirement and ask you to reconsider both. We urge you to either eliminate it from the regulation, or modify it dramatically for the reasons described above. You may accomplish the same objective by revising provisions to Part 703 related to investments that natural-person credit unions may make in member-contributed capital at corporate credit unions. The current limit exceeds prudent investment standards for natural-person credit unions as we indicated in our comment letter to you during the previous rewrite of Part 703 several years ago.

§704.9 Liquidity Management

The Proposed Regulation would limit the weighted average life of EasCorp's investment portfolio to 2 years. What's more, EasCorp would be limited to borrowing for liquidity purposes only and for a period no longer than 30 days. In combination, these limits would effectively prevent EasCorp from providing "matched-funded" term loans to member credit unions. Match funded loans present no interest rate risk to EasCorp. Because we make loans to creditworthy members only, we are hard pressed to understand why the Proposed Regulation would restrict this activity. It would take a valuable source of funding away from natural-person credit unions, especially at a time when borrowing rates are very favorable to them. We urge NCUA to reconsider this limitation and change it.

§704.11 Corporate Credit Union Service Organiations (Corporate CUSOs)

The Proposed Regulation would replace the current list of prohibited activities with a section on permissible activities, and a corporate CUSO would have to limit its activities to only those included in this section or otherwise approved by NCUA. The list of permissible activities identifies two items. EasCorp would be interested in knowing why the codified list of permissible activities is so short and, more important, why these (two) particular activities were selected. We own shares, of varying levels of ownership interest, in four CUSOs, only one of which would be immediately permitted under the Proposed Regulation.

There would be meaningful consequences for our members, and credit unions generally, if NCUA did not approve certain CUSO activities. For instance, EasCorp, and many other corporate credit unions, have performed item processing for members for more than 20 years. During 2009 with NCUA's encouragement, we assigned this activity to a wholly-owned CUSO in order to separate the operational risk from EasCorp. We have a very substantial share of our geographic market for this service, underscoring the excellent financial value we provide to credit unions. It is a simple matter of fact that credit unions would be forced to purchase these services at much higher prices from other providers if they are unable to purchase them from our CUSO in the future because this activity was no longer approved by NCUA.

Notwithstanding our self-interest in the outcome of the CUSO provision to the Proposed Regulation, we believe as a simple matter of fairness that NCUA should present a lengthier list of permissible activities in the regulation so that corporate credit unions can know what the rules are rather than having to rely on an unpredictable administrative process. We also urge NCUA to "grandfather" existing corporate CUSOs so as to remove any doubt in the marketplace about their legal standing.

Also with respect to Corporate CUSOs, the Proposed Regulation would have us deduct the amount of our investment in the CUSO from available capital in the calculation of our Capital Ratios. It is uncertain to us what the rationale for this is, especially if the CUSO is profitable. NCUA should reconsider this provision entirely.

§704.14 Representation

The Proposed Regulation would limit EasCorp's Board members from serving more than 6 years. Due to the length of their tenure, many of EasCorp's Board members would be ineligible for reelection when their terms expire. At a time when EasCorp, and other corporate credit unions, are rebuilding their franchises, term limitations on Directors would be a very destabilizing force, and we urge NCUA to delete this provision from the Proposed Regulation entirely.

In closing, we thank you once again for this opportunity to comment on the Proposed Corporate Credit Union Regulation.

Sincerely,

Jane C. Melchionda

Jane C. Melchionda
President/CEO

JM/md